CAPITAL DIVERSIFIED INDUSTRIES LIMITED

ANNUAL REPORT NINETEEN HUNDRED AND SEVENTY

CAPITAL DIVERSIFIED INDUSTRIES LIMITED ANNUAL REPORT 1970

DIVISIONS AND DIVISION MANAGEMENT

CONSTRUCTION AND DEVELOPMENT DIVISION

Capital Homes Limited

Frederick W. Hoener, General Manager

Emanuel J. Asciak, General Manager (Windsor)

FRONTIER ACCEPTANCE DIVISION

Frontier Acceptance Corporation Limited

Donald W. McTavish, General Manager

RED BARN DIVISION

Red Barn System (Canada) Limited

Murray S. Lorimer, General Manager

PRICEGARD DIVISION

Pricegard Limited

Edward J. Day, General Manager

CAPITAL FOODS DIVISION

Middlesex Reddies Limited

Middlesex Creamery Limited

Fred Pamenter, General Manager

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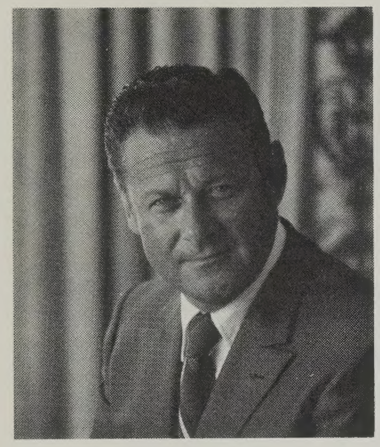


PRESIDENT'S REPORT TO THE SHAREHOLDERS

Operating results for 1970 reflected the recessionary influences of the national economy. Consolidated net earnings were $.02 a common share compared to $.12 a common share in 1969.

The downtrend of the general economy resulted in reduced profit margins and consequently portions of our planned expansion programs were deferred.

The wisdom of our diversification is quite evident in reviewing the past year. For example, unusually high interest rates and high unemployment reduced our housing activities to 22 sales, while at the same time, our Capital Foods Division added 12,000 square feet to its Strathroy plant, maintained its 1969 sales volume and increased its profits.

Divisional reviews are submitted for your information in the following pages of this report.

In October, 1970, Capital moved its head office to its new office building at 195 Dufferin Avenue, London, Ontario.

Our financial position was considerably strengthened as witnessed by our balance sheet that shows a positive working capital position of $1,193,000 as compared to a deficit of $298,000 a year ago.

I would like to thank all our Directors on your behalf for their untiring efforts and support during the trying year of 1970.

It is also a pleasure to express on your behalf our appreciation to all personnel for their loyalty and dedication to the Company during the past year.

While 1970 was not as profitable as anticipated, we did operate on a profitable basis and were able to reach some of our objectives, such as the expansion of our Capital Foods operation which resulted in increased efficiency and profitability, and the opening of seven new Red Barn units during the year.

Current economic indicators are confusing, making it extremely difficult to project the immediate future. Reduction of the exceptionally high unemployment is no doubt the key to the reversal of the current economic decline. In the meantime, we are employing all of the management skills at our disposal to continue a profitable operation.

March 22, 1971

D. H. Swift

President

FINANCIAL REVIEW

Consolidated net earnings for the year 1970 were $170,238 as compared with $514,766 for 1969. Net earnings per common share were $.02 and $.12, respectively, for the two periods after preference dividends.

The reason for the decline in net earnings in spite of increased sales was the erosion of profit margins due to increased competition and heavy price cutting in most areas of consumer business. This was especially prevalent during the last half of the year. In addition to this, although total sales increased, the general economy was such that it was not possible to increase sales to the levels necessary to cover increased selling, administrative and interest expenses.

As reported in the third quarter, the year 1970 was also abnormally affected by an extraordinary charge of $110,466 which was the balance of an investment in a partnership participation agreement that was designed in 1963 to develop and sell certain commercial and residential properties in Montreal. Some sales were made, but due to economic conditions and unusually slow growth in the area this amount remained as Capital's portion of the investment when the agreement expired and had to be written off. This represented approximately $.03 a share.

Another distortion in 1970 is the provision for income taxes. Under reporting rules laid down by the Canadian Institute of Chartered Accountants full taxes must be provided on all profits, credits can be taken for losses only in certain restricted situations, and any tax reductions arising from the carryforward of prior years' losses must be shown as extraordinary income. This practice can have a very distorting effect in a particular year as is evident by the normal tax provision being shown at 74% of earnings before tax with a $200,800 tax credit being shown as extraordinary income. The actual tax provision of $71,927 was in reality 20% of earnings before tax, and there is still approximately $400,000 of accumulated tax losses to apply against future income.

At the end of 1969 working capital was in a deficit position brought about, as was then reported, by the substantial investment during the preceding two years in Red Barn real estate and the inability to completely finance this expansion through long term debt with satisfactory interest rates and conditions. During 1970 working capital was returned to a substantial positive position by: 1. a moderate amount of mortgage financing of certain Red Barn lands, and; 2. the rearrangement with our bankers of our bank indebtedness to allow for the orderly repayment over approximately a three year period. This banking arrangement is described more fully in Notes 4 and 7 to the financial statements included in this report.

Continued attention to maintaining an orderly debt structure, plus the expected sales of certain commercial real estate holdings, should result in a continued satisfactory working capital position in the future.

The reduction in shareholders' equity was caused by the redemption during the year of $120,000 of Series "B" Preference Shares in accordance with normal sinking fund requirements.

	1970	1969	1968	1967
Gross Revenues:				
Sales	$19,680,447	$15,098,317	$ 5,390,483	$ 5,889,088
Rentals, royalties, interest and fees	1,539,039	1,848,608	906,352	117,300
	$21,219,486	$16,946,925	$ 6,296,835	$ 6,006,388
Earnings before interest, depreciation and income taxes	$ 1,721,206	$ 1,781,019	$ 1,234,389	$ 453,498
Interest expense	954,882	511,852	263,332	141,518
Depreciation and amortization	396,668	249,052	63,432	26,903
Earnings before income taxes	369,656	1,020,115	907,625	285,077
Provision for income taxes	272,727	574,000	480,944	146,500
Earnings before extraordinary items	96,929	446,115	426,681	138,577
Extraordinary items:				
Loss on expiration of participation agreement	(110,466)	—	—	—
Reduction of income taxes as a result of the application of prior years' losses	200,800	37,702	290,390	—
Capital gains and miscellaneous (net)	(17,025)	30,949	5,900	(36,570)
	73,309	68,651	296,290	(36,570)
Net Earnings	$ 170,238	$ 514,766	$ 722,971	$ 102,007
Preference dividends (including Finance subsidiary)	$ 89,030	$ 52,943	$ 13,961	$ 24,977
Earnings per common share on average shares outstanding:				
Before extraordinary items, but after preference share dividends	$ —	$ .10	$ .12	$ .06
After extraordinary items and preference share dividends	$ .02	$ .12	$ .21	$ .04
Average shares outstanding during year, adjusted for poolings	3,936,190	3,928,240	3,334,800	2,044,220
Total assets, including Frontier Acceptance	$26,912,007	$30,270,320	$21,124,439	$ 6,862,745
Working capital (deficit)	1,193,150	(297,758)	144,370	1,093,962
Commercial real estate and fixed assets (net)	11,129,568	10,379,420	4,543,773	2,559,272
Long-term debt	10,552,510	8,204,530	2,892,220	3,205,521
Shareholders' equity (historical without adjustments for pooling)	8,098,725	8,137,517	6,040,444	2,069,805

The year 1967 includes the operations of Frontier Acceptance Corporation Limited which was acquired in 1968 on a pooling of interests basis.

A CAPITAL DIVERSIFIED COMPANY

RED BARN DIVISION

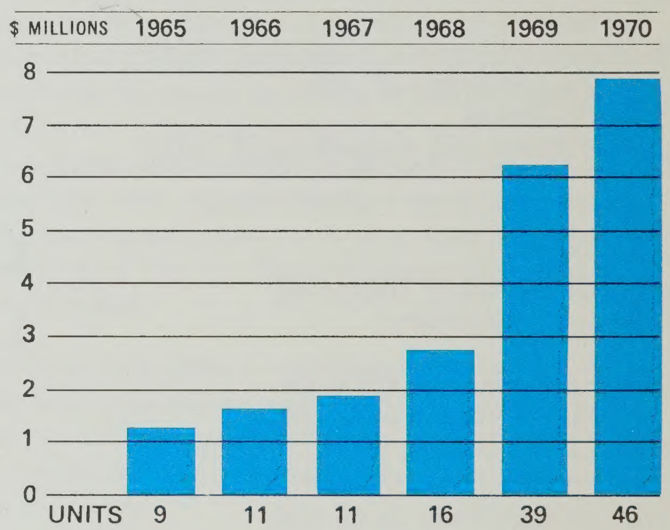
Total sales of all Company operated and franchised Red Barn units for the year were $7,965,000 compared to $6,242,000 for 1969, an increase of $1,723,000. However, average individual restaurant gross sales on an annualized basis declined from $240,000 to $184,000, a reflection of general economic conditions and increased competition in the fast food industry.

Appointment of J. Walter Thompson Company Limited as Red Barn's advertising agency was announced in the latter part of the year. It is expected this agency will give Red Barn the support required to maintain and improve its position in the fast food industry in Canada. J. Walter Thompson Company Limited is the largest advertising agency in the world and is responsible for the advertising program of Red Barn U.S.A. A new marketing and advertising program went into effect in March, 1971.

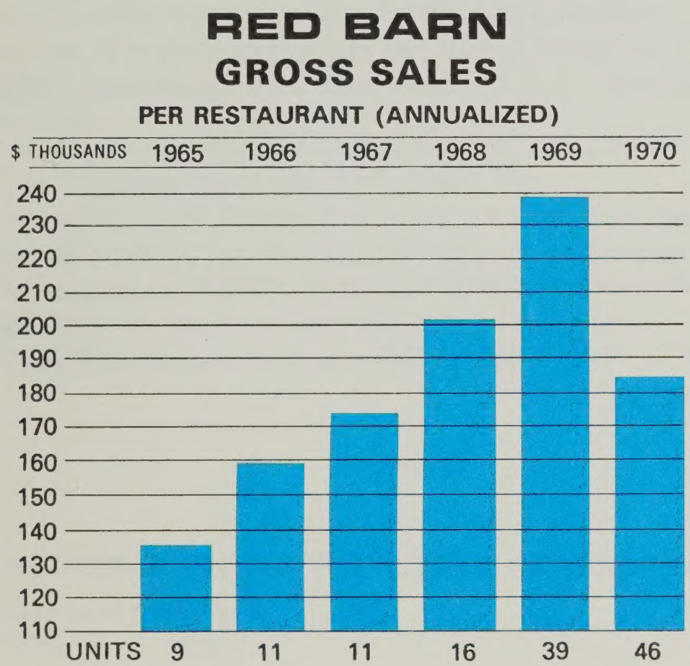
There are now 46 Red Barn restaurants in Ontario and Quebec. Of these, 32 are franchised and 14 are company operated. In 1970 new restaurants were opened in Belleville, Kitchener, Hull, Whitby, Sault Ste. Marie, North Bay and Sudbury.

Red Barn's objective for 1971 is to open 10 new outlets in Ontario and Quebec. This plan, of course, will depend upon general economic conditions and the availability of suitable financing.

RED BARN
GROSS SALES
COMPANY AND FRANCHISED UNITS



RED BARN DIVISION (CONTINUED)



Red Barn System (Western) Limited has opened its first unit in the Vancouver area. Plans are to open additional units to adequately cover the market in this area.

During 1970 four Red Barn restaurants were opened in Australia by the licensee, Spotless Limited, bringing the total in operation to seven. Plans for 1971 in Australia call for five new units, two of which are now under construction. Reported sales continue to be satisfactory and Red Barn's future in Australia appears assured.

While the fast food industry, including Red Barn, experienced problems in 1970 because of the general economic downturn, we have continued our policy of establishing a national chain of restaurants with the emphasis on Service, Quality and Cleanliness, that should ensure continuing patronage.

A CAPITAL DIVERSIFIED COMPANY

FRONTIER ACCEPTANCE DIVISION

Toward the end of 1969, Frontier Acceptance made budget forecasts for 1970 based on an expected down-turning economy and tight money. Timing and accuracy of the budget forecast paid off in economies of operation which produced continuing profitability notwithstanding declining receivables and subsequent lower gross income.

General expenses, including salaries, declined during 1970 with the result that net profit as a percentage of gross income was increased. It was a year of consolidating and trimming both fixed and variable costs and lower profit portfolios. Lower yielding receivables were decreased and surplus cash was used to reduce bank loans, all of which resulted in another profitable year for Frontier Acceptance Division.

Frontier Acceptance assisted in developing mortgaging for the Construction and Development Division and financed Red Barn equipment packages on a mutually profitable basis.

At December 31, 1970 notes receivable from Capital Diversified Industries Limited and Consolidated Subsidiaries amounted to $794,253 and receivables representing Red Barn equipment leases amounted to $2,279,540 including unearned finance charges.

Indications for 1971 are promising with monetary improvement and lower interest rates significant. The lower cost of borrowing will enhance the earnings to be derived from the existing portfolio of receivables.

At December 31, 1970 the details of Frontier's receivables were as follows:

Retail:	
Mobile homes	$3,806,219
Other consumer retail instalment	50,830
Direct consumer cash loans	542,653
Commercial loans	3,732,038
	$8,131,740
Wholesale	95,874
	$8,227,614
Less:	
Unearned finance charges	1,334,686
Allowance for possible losses	71,260
	1,405,946
NOTES RECEIVABLE — NET	$6,821,668

CONDENSED BALANCE SHEET

	December 31 1970	1969
ASSETS		
Cash	$ 93,051	$ 223,805
Notes receivable, net of unearned finance charges and allowance for possible losses	6,821,668	9,842,002
Other assets and deferred charges	180,997	153,449
	$ 7,095,716	$10,219,256
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-term notes payable to banks secured	$ 2,798,000	$ 5,549,000
Accounts payable, accrued liabilities, income taxes and dealers credit balances	344,540	517,615
Capital funds:		
Long-term subordinated debt	2,188,313	2,465,438
Shareholders' equity:		
Preference shares	384,250	384,250
Common shares	575,463	575,463
Retained earnings	805,150	727,490
TOTAL SHAREHOLDERS' EQUITY	$ 1,764,863	$ 1,687,203
TOTAL CAPITAL FUNDS	$ 3,953,176	$ 4,152,641
	$ 7,095,716	$10,219,256

CONDENSED STATEMENT OF NET EARNINGS

	Year Ended December 31 1970	1969
Finance charges, interest and fees earned	$ 1,019,186	$ 1,322,310
Deduct:		
Salaries and wages	81,919	106,478
Administrative charge from parent company	100,000	75,000
Other general and administrative expenses	90,790	166,446
Provision for possible losses	14,784	43,211
Cost of borrowings, principally interest	542,206	705,237
	$ 829,699	$ 1,096,372
Earnings before taxes on income	$ 189,487	$ 225,938
Taxes on income	86,850	115,300
NET EARNINGS	$ 102,637	$ 110,638

A CAPITAL DIVERSIFIED COMPANY

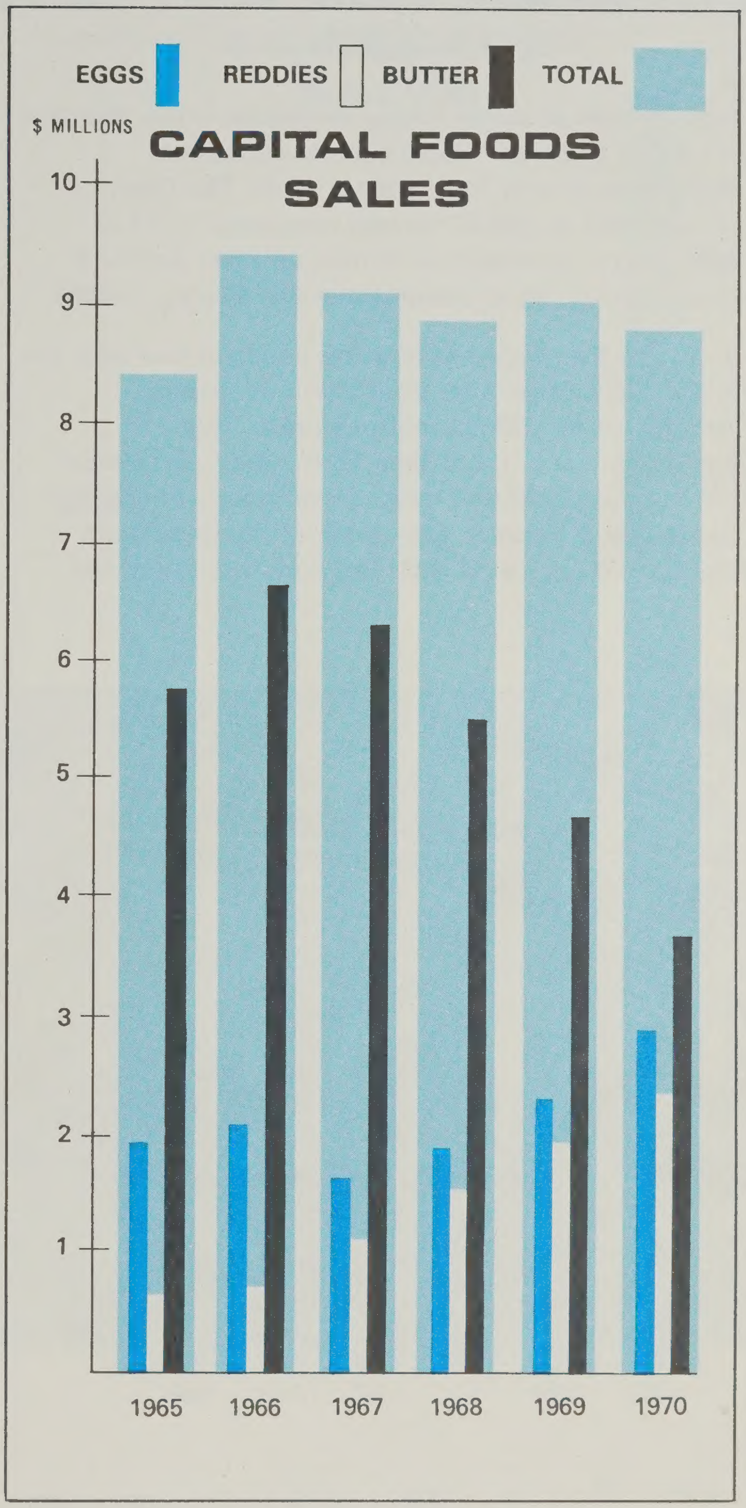
CAPITAL FOODS DIVISION

Total sales for the Division in 1970 were almost equal to the previous year, while profits increased.

Integration of the Cuddy Foods egg processing operations in Strathroy, acquired late in 1969, increased substantially the number of dozens of eggs sold. However, lower average prices in the last half of 1970 reduced the comparable dollar sales increase.

Reddies sales increased 10 per cent over the previous year. However, competition in pre-portioned butter has intensified and will make it difficult to maintain this rate of growth in 1971. In the United Kingdom sales of Reddies are now in process.

On December 1, the new 12,000 square foot addition to the Strathroy plant was completed. The combination of all Capital Foods operations under one roof will produce benefits in efficiency and operating cost reductions in 1971. Plans for 1971 include expanding our product lines that can be integrated with our distribution and sales systems.



A CAPITAL DIVERSIFIED COMPANY

CONSTRUCTION AND DEVELOPMENT DIVISION

Construction of single family dwellings in the Windsor area again declined due to general economic circumstances and high interest rates. The Division was still able to sell 22 houses compared to 31 in 1969 and the inventory of homes on hand declined at year end to 10, of which three are display models.

Offsetting the decline in housing construction was the $3,700,000 contract for the Ontario Housing Corporation for 220 townhouse units. This development was more than 75 per cent completed at the end of 1970 and costs were maintained within the original estimates. Eighty-six of the units have been turned over to O.H.C. and construction of the balance will be completed by late spring or early summer.

The Division continued to concentrate on reducing unprofitable land inventory and obtaining additional tenants for the eight-storey office building in London, now approximately 55 per cent rented. Again, high interest rates and the generally slow pace of the economy hampered the Division.

In 1971 the Division will continue to build the houses it believes it can sell on serviced building lots that are available. The Division also will continue to explore the feasibility of other construction projects.

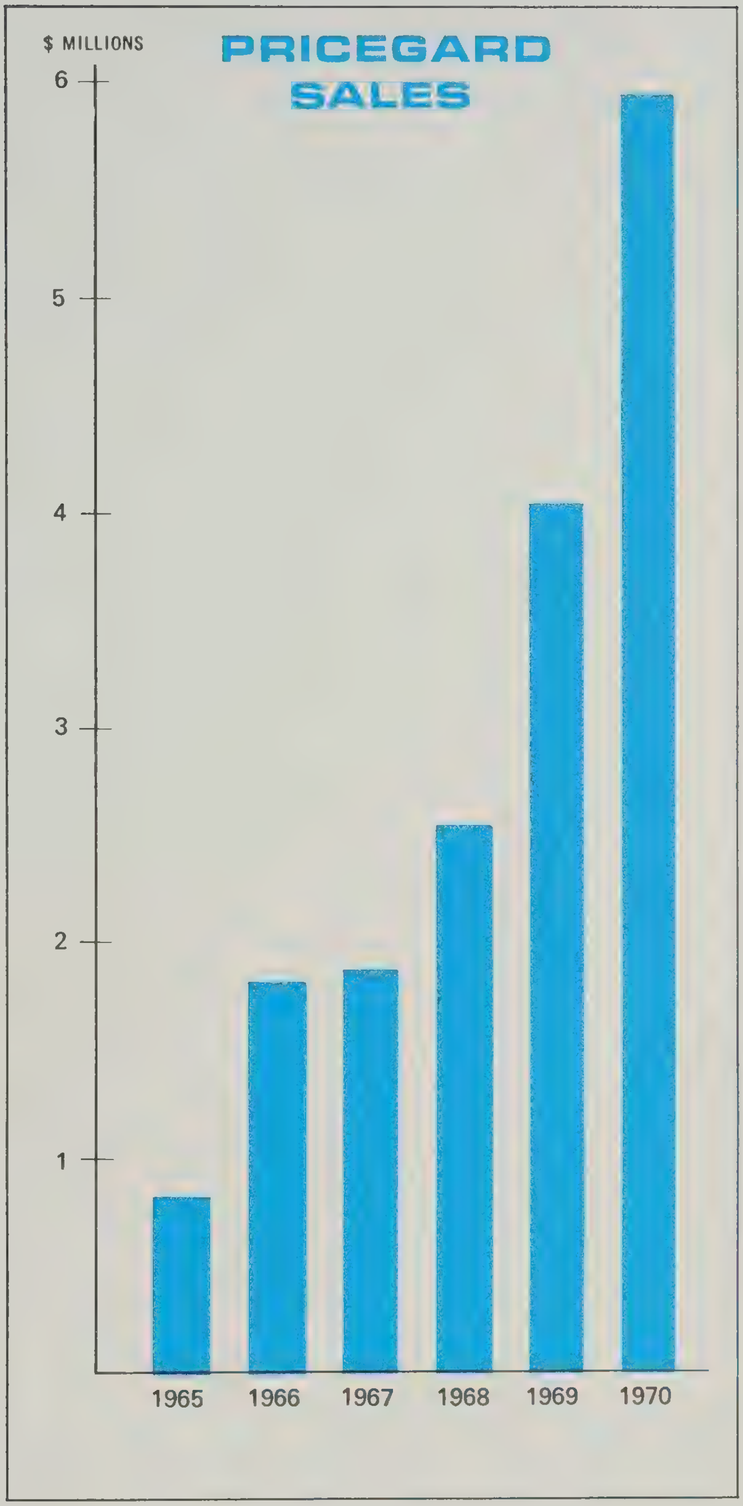
Part of the 220-unit development of townhouses in Windsor undertaken for Ontario Housing Corporation which was 75 per cent completed in 1970.

PRICEGARD DIVISION

Sales were approximately $6,000,000, which is less than had been projected. Price pressure from major chain supermarkets and full line discount stores in the health and beauty aid lines held sales and profit margins down. The result was an operating loss for the year 1970.

Because of the foregoing situation the expansion program was limited to the opening of five stores which replaced five stores that were closed due to unprofitable operations and in some instances duplication of location that was brought about by acquisitions. This now leaves the total number of operating outlets at 28.

There is no doubt the competitive factor will remain. However, there are positive signs of reduced pressure on gross margins which, along with improved product selection and marketing strategies, will hopefully return the Division to a profit position.



CAPITAL DIVERSIFIED INDUSTRIES LIMITED
(INCORPORATED UNDER THE LAWS OF ONTARIO)
AND ITS SUBSIDIARY COMPANIES
CONSOLIDATED BALANCE SHEET
DECEMBER 31, 1970
(WITH COMPARATIVE AMOUNTS AT DECEMBER 31, 1969)

ASSETS

	1970	1969
CURRENT:		
Accounts receivable:		
Trade	$ 838,443	$ 1,221,598
Construction holdbacks	450,543	—
Mortgage draws	17,000	74,300
Current portion of mortgages and notes receivable	138,999	240,948
Inventories at lower of cost and net realizable value:		
Real estate	113,413	531,755
Land and improvements not yet utilized in construction	710,416	868,668
Millwork materials	—	63,852
Retail and wholesale merchandise	1,308,902	1,639,799
Sundry assets and prepaid expenses	167,688	120,302
Income taxes recoverable	123,100	—
	$ 3,868,504	$ 4,761,222
INVESTMENTS:		
Commercial real estate at cost less accumulated depreciation (note 2)	$ 4,144,750	$ 4,107,554
Mortgages and notes receivable — non-current portion	782,392	1,197,667
Investment in and advances to other companies at cost	547,381	334,304
Investment in Frontier Acceptance Corporation Limited at equity in net assets (note 1)	1,743,613	1,660,578
	$ 7,218,136	$ 7,300,103
FIXED (note 3):		
Land, buildings, equipment and leasehold improvements at cost	$ 7,916,813	$ 6,946,842
Less accumulated depreciation and amortization	931,995	674,976
	$ 6,984,818	$ 6,271,866
OTHER:		
Organization expenses and deferred charges less accumulated amortization	$ 212,830	$ 179,618
Deferred financing expenses less accumulated amortization	355,684	392,611
Goodwill at cost	186,100	173,600
Excess of cost of shares of subsidiaries over equity acquired therein	2,733,832	2,632,622
	$ 3,488,446	$ 3,378,451
	$21,559,904	$21,711,642

Approved on behalf of the Board

JOHN D. HARRISON, M.B.E., Q.C., Director   CLARENCE W. LEONARDI, C.A., Director

LIABILITIES

	1970	1969
CURRENT:		
Bank indebtedness — secured (note 4)	$ 530,638	$ 2,520,606
Accounts payable and accrued liabilities	1,669,269	2,198,572
Income taxes payable	—	219,252
Current portion of mortgages and notes payable	475,447	120,550
	$ 2,675,354	$ 5,058,980
DEFERRED INCOME TAXES (note 5)	50,315	35,615
DEFERRED INCOME FROM SALE OF AREA LICENCES (note 6)	183,000	275,000
MORTGAGES AND NOTES PAYABLE — non-current portion (note 7)	5,552,510	3,204,530
8½% CONVERTIBLE SUBORDINATED DEBENTURES — unsecured (note 8)	5,000,000	5,000,000
SHAREHOLDERS' EQUITY:		
CAPITAL (note 9):		
Authorized:		
25,000 5½% cumulative convertible sinking fund Class "A" preference shares redeemable at their par value of $40 each		
12,000 6% cumulative sinking fund Class "B" preference shares redeemable at their par value of $40 each		
1,000,000 Class "C" preference shares, par value $10 each		
10,000,000 common shares without par value		
Issued and fully paid:		
25,000 5½% cumulative redeemable convertible sinking fund Class "A" preference shares	$ 1,000,000	$ 1,000,000
12,000 6% cumulative redeemable sinking fund Class "B" preference shares	480,000	600,000
3,936,190 common shares	6,000,143	6,000,143
	$ 7,480,143	$ 7,600,143
CONSOLIDATED RETAINED EARNINGS	618,582	537,374
	$ 8,098,725	$ 8,137,517
	$21,559,904	$21,711,642

(See accompanying notes to the consolidated financial statements)

CONSOLIDATED STATEMENT OF EARNINGS YEAR ENDED DECEMBER 31, 1970
(WITH COMPARATIVE AMOUNTS FOR 1969)

	1970	1969
SALES	$19,680,447	$15,098,317
RENTALS, ROYALTIES, INTEREST AND FEES	1,539,039	1,848,608
	$21,219,486	$16,946,925
LESS		
Cost of sales	$16,718,133	$13,310,190
Selling, general and administrative	2,969,634	2,081,654
Interest on long-term debt	597,416	230,087
Other interest (including interest on bank loans)	357,466	281,765
Depreciation and amortization	351,145	237,113
Amortization of financing expenses	45,523	11,939
	$21,039,317	$16,152,748
	$ 180,169	$ 794,177
EARNINGS OF FRONTIER ACCEPTANCE CORPORATION LIMITED, before income taxes (note 1)	189,487	225,938
Earnings, before income taxes	369,656	1,020,115
Provision for income taxes — current	258,027	567,700
— deferred (note 5)	14,700	6,300
	$ 272,727	$ 574,000
Earnings from operations, before extraordinary items	$ 96,929	$ 446,115
EXTRAORDINARY ITEMS:		
Loss on sale of marketable securities	(781)	(7,244)
Capital gain on expropriation	—	22,050
Capital gain on note discounted	—	22,500
Gain (loss) on disposal of fixed assets	(16,244)	3,465
Loss on expiration of participation agreement	(110,466)	—
Provision for prior years' deferred income taxes	—	(9,822)
Reduction of income taxes as a result of the application of prior years' losses (note 12)	200,800	37,702
	$ 73,309	$ 68,651
NET EARNINGS FOR THE YEAR	$ 170,238	$ 514,766
Earnings per common share on average shares outstanding (note 14):		
Before extraordinary items, but after preference share dividends	$—	$.10
After extraordinary items and preference share dividends	$.02	$.12

CONSOLIDATED STATEMENT OF RETAINED EARNINGS YEAR ENDED DECEMBER 31, 1970
(WITH COMPARATIVE AMOUNTS FOR 1969)

	1970	1969
Balance, beginning of year	$ 537,374	$ 75,551
Add consolidated net earnings for the year	170,238	514,766
	$ 707,612	$ 590,317
Deduct:		
Preference dividends paid	87,400	50,985
Preference dividends of unconsolidated finance subsidiary	1,630	1,958
	$ 89,030	$ 52,943
Balance, end of year	$ 618,582	$ 537,374

(See accompanying notes to the consolidated financial statements)

CONSOLIDATED STATEMENT OF SOURCE AND USE OF FUNDS, YEAR ENDED DECEMBER 31, 1970

(WITH COMPARATIVE AMOUNTS FOR 1969)

	1970	1969
FUNDS PROVIDED:		
Net earnings for the year	$ 170,238	$ 514,766
Add charges not requiring an outlay of funds:		
Depreciation and amortization	351,145	237,113
Amortization of financing expense	45,523	11,939
Increase in deferred taxes on income	14,700	35,615
	$ 581,606	$ 799,433
Less income not providing funds — net earnings of unconsolidated finance subsidiary less dividends received therefrom	79,289	87,619
Funds provided from operations	502,317	711,814
Increase (net) in mortgages and notes payable including in 1970 the reclassification of a portion ($1,550,000) of the company's bank indebtedness as a long-term liability	2,347,980	1,107,221
Proceeds from issue of capital stock	—	1,635,250
Proceeds from issue of 8½% convertible subordinated debentures	—	5,000,000
Total funds provided	$ 2,850,297	$ 8,454,285
USE OF FUNDS:		
Acquisition of fixed assets (net)	$ 1,016,852	$ 4,428,989
Increase (decrease) in investments:		
Commercial real estate	74,996	1,643,771
Mortgages and notes receivable	(415,275)	115,070
Other companies	213,077	133,008
Unconsolidated finance subsidiary	5,375	7,375
Repayment of secured income debentures	—	794,911
Excess cost of shares of subsidiaries over equity acquired therein	101,210	1,257,963
Redemption of class "B" preference shares	120,000	—
Payment of dividends	87,400	50,985
Decrease (increase) in deferred income from sale of area licences	92,000	(195,000)
Increase in goodwill	12,500	173,600
Increase in organization expenses and deferred charges	42,658	117,950
Increase in deferred financing expenses	8,596	367,791
Total funds used	$ 1,359,389	$ 8,896,413
Increase (decrease) in consolidated working capital	1,490,908	(442,128)
Consolidated working capital (working capital deficit), beginning of year	(297,758)	144,370
Consolidated working capital (working capital deficit), end of year	$ 1,193,150	$ (297,758)

(See accompanying notes to the consolidated financial statements)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 1970

1. PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Capital Diversified Industries Limited and (with the exception of Frontier Acceptance Corporation Limited) the accounts of all subsidiary companies. The operating results of subsidiary companies acquired during the year are included in the consolidated results of operations only for the period from the date of acquisition of the subsidiary.

The accounts of Frontier Acceptance Corporation Limited are not included in the attached consolidated financial statements because the nature of this company's operations are substantially different from those of the parent company and its consolidated subsidiaries.

The attached consolidated statement of earnings includes in both 1970 and 1969 the net income of Frontier Acceptance Corporation Limited and the parent company's investment in this subsidiary is included in the attached consolidated balance sheet at an amount equal to the interest of the parent company in the book value of the underlying net assets of this subsidiary after making provision for shares held by minority shareholders.

Under the most restrictive covenants of certain loan agreements of Frontier Acceptance Corporation Limited, no portion of that company's retained earnings at December 31, 1970 was available for the payment of dividends on its common shares.

Amounts of $65,000 in 1970 and $115,570 in 1969 which are due from Frontier Acceptance Corporation Limited are included in trade accounts receivable in the consolidated balance sheet.

2. COMMERCIAL REAL ESTATE

Details of commercial real estate are as follows:

	1970	1969
Land	$1,356,047	$1,351,986
Buildings	2,889,772	2,818,837
	$4,245,819	$4,170,823
Less accumulated depreciation	101,069	63,269
	$4,144,750	$4,107,554

3. FIXED ASSETS

Details of fixed assets are as follows:

	1970	1969
Land	$2,659,525	$2,333,940
Buildings	3,939,263	3,054,186
Equipment	1,174,241	1,451,061
Leasehold improvements	143,784	107,655
	$7,916,813	$6,946,842
Less accumulated depreciation and amortization	931,995	674,976
	$6,984,818	$6,271,866

4. BANK INDEBTEDNESS — CURRENT PORTION

The current portion of the companies' bank indebtedness includes in 1970 obligations to bankers of certain subsidiary companies aggregating $182,452 against which the accounts receivable and inventories of these subsidiaries have been pledged. This amount also includes in that year the current portion of the bank indebtedness of the parent company and the remainder of the consolidated subsidiaries which amounted to $348,186 at December 31, 1970 and which is due within one year under the terms of a debenture issued by the companies to their bankers during the year the details of which are set out in note 7 below. In 1969 the current portion of the companies' bank indebtedness included the total obligations of the companies to their bankers and no amount was shown as a deferred liability.

5. DEFERRED INCOME TAXES

Deferred income taxes of $50,315 at December 31, 1970 ($35,615 at December 31, 1969) represent the amounts by which income taxes otherwise payable in 1970 and prior years have been reduced by claiming for income tax purposes capital cost allowances in excess of depreciation recorded in the accounts. These amounts are applicable to those future accounting periods in which capital cost allowances available for income tax purposes will be less than depreciation recorded in the accounts.

6. DEFERRED INCOME FROM SALE OF AREA LICENCES

The company's accounting policy with respect to the recognition of income from the sale of franchises and area licences is as follows:

(a) Proceeds from the sale of individual franchises are receivable in cash, and the income from the sale of these franchises is recognized in the period in which the franchisee becomes obligated by the terms of the franchise agreement to pay such fee.

(b) Proceeds from the sale of area licences, which are receivable partly in cash at the time the area licence is assigned to the licencee and partly by way of notes which are payable over a period of years are recognized as receivables in the period in which the licencee becomes obligated by the terms of the agreement to pay such fees. However, the portion of the sale price which is represented by notes due over a period of years is recorded in the accounts as deferred income from the sale of area licences and is recognized as income only when cash is received from the licencee in payment of the notes.

7. MORTGAGES AND NOTES PAYABLE

Details of these obligations are as follows:

	1970		1969
	Mortgages and notes payable	Bank indebtedness	Mortgages and notes payable
Bank—secured (bearing interest at an annual rate of 10%)		$1,898,186	
First mortgages (bearing interest at annual rates varying from 6% to 12%)	$2,819,226		$1,444,964
Second mortgages (bearing interest at annual rates varying from 10% to 12%)	862,347		160,852
Secured notes (bearing interest at annual rates varying from 7¼% to 12½%)	195,268		1,664,084
Unsecured notes (bearing interest at annual rates varying from 8% to 12%)	601,116		55,180
	$4,477,957	$1,898,186	$3,325,080
Less amounts due within one year and included in current liabilities	475,447	348,186	120,550
	$4,002,510	$1,550,000	$3,204,530

Principal repayments required in respect of the above obligations in future years are as follows:

	Mortgages and notes payable	Bank indebtedness	Total
1971	$ 475,447	$ 348,186	$ 823,633
1972	690,570	1,050,000	1,740,570
1973	590,491	500,000	1,090,491
1974	171,862		171,862
1975	1,531,076		1,531,076
Total due within five years	3,459,446	1,898,186	5,357,632
1976 - 1980	499,979		499,979
After 1980	518,532		518,532
	$4,477,957	$1,898,186	$6,376,143

Although the total bank indebtedness of $1,898,186 is due on demand, the bank has agreed to allow repayment of this amount over a period of approximately three years beginning April, 1971 on the condition that during that period the bank continues to be satisfied with the financial position and operating results of the companies. The bank has also indicated in a letter dated March 5, 1971 that it does not presently intend to demand payment of this loan in full prior to December 31, 1971 and does not intend to accelerate the repayment provisions referred to above unless the financial position of the companies as reflected in the attached consolidated financial statements changes adversely to the extent that the bank considers it necessary to take such action. Accordingly, only that portion of the total bank indebtedness required by the terms of the above agreement with the bank to be repaid within one year is shown as a current liability in the attached consolidated financial statements.

As collateral security for this loan the company has given the bank; (1) a 10% demand debenture in the principal amount of $2,000,000 which grants to the bank a fixed, specific and floating charge on all of the assets of Capital Diversified Industries Limited and of two of its consolidated subsidiaries, Red Barn System (Canada) Limited and Pricegard Limited and (2) a collateral mortgage on certain assets of two other consolidated subsidiaries. The charges held by the bank on these assets rank second to any prior encumbrances previously registered against these assets.

Mortgages and notes payable include; (1) amounts owing to Frontier Acceptance Corporation Limited (the unconsolidated finance subsidiary) of $794,253 at December 31, 1970 and $1,571,253 at December 31, 1969 of which $34,000 in 1970 and $27,000 in 1969 is due within one year and accordingly is included in the current portion of these obligations; and (2) $520,000 at December 31, 1970 owing to the holder of all of the issued and outstanding Class "B" preference shares of which $20,000 is due within one year and accordingly is included in the current portion of this obligation.

8. 8½% CONVERTIBLE SUBORDINATED DEBENTURES

The 8½% convertible subordinated debentures are due on November 15, 1979 and are convertible into common shares of the company at any time prior to November 15, 1974 at a rate of $4.25 per share and thereafter, at any time prior to maturity, at a rate of $6.00 per share.

9. CAPITAL STOCK

(a) The sinking fund requirements of the outstanding preference shares are as follows:

Class "A" — on or before the 30th day of June, 1972 - $100,000
— on or before the 30th day of June for each year 1973 to 1979 - $128,571

Class "B" — on or before the 30th day of June for each year 1971 to 1974 - $120,000

During the year 3,000 Class "B" preference shares with a par value of $40 each were redeemed at par for cash in accordance with sinking fund requirements.

(b) The Class "A" preference shares may be converted at the option of the holder into common shares of the company on the basis of 5 common shares for each Class "A" preference share held.

(c) Under a by-law approved by the shareholders on April 28, 1969 the company was authorized to establish stock purchase and option plans for employees and to make available 100,000 unissued common shares in the capital stock of the company to be used for such employee stock purchase and option plans to be established by the Board of Directors. Subsequent to December 31, 1970 the company granted options to purchase 83,000 common shares to certain of its senior officers and to a certain senior officer of one of its wholly-owned subsidiaries at a price of $1.25 per share and cancelled all previously outstanding employee purchase option agreements.

(d) Of the authorized and unissued common shares of the company at December 31, 1970; 230,454 shares are reserved for share purchase warrants — Series "A" (issued in connection with the acquisition of substantially all of the preference and common shares of Frontier Acceptance Corporation Limited) exercisable at $3.00 a share on or before expiration date July 16, 1973; 41,600 shares are reserved for share purchase warrants — Series "B" exercisable at $2.50 a share until June 30, 1973; and thereafter at $3.50 a share until expiration date June 30, 1978; 48,000 shares are reserved for share purchase warrants — Series "C" exercisable at $2.50 a share until expiration date December 15, 1977; 125,000 shares are reserved for conversion of the 5½% Class "A" preference shares at $8.00 a share; 1,176,470 shares are reserved for conversion of the 8½% convertible subordinated debentures at $4.25 a share until November 15, 1974; and thereafter at $6.00 a share until expiration date November 15, 1979; and 100,000 common shares are reserved for employee stock option and purchase plans.

10. COMMITMENTS

(a) Leases

Minimum annual rental payments required to be made by the companies under the terms of lease agreements which extend for a period of more than five years from December 31, 1970 are as follows:

1971	$386,000	1980-82	$167,000
1972	380,200	1983	154,000
1973	361,000	1984	119,000
1974	333,000	1985	87,000
1975	307,000	1986-88	71,000
1976	290,000	1989	49,000
1977	238,000	1990	37,000
1978	198,000	1991-95	35,000
1979	179,000	1996-98	15,000
		1999-2018	16,000

(b) Spotless Limited

The company is to acquire at certain times and under certain conditions up to December 31, 1973, a 25% interest in Spotless Limited, an Australian public company which owns the exclusive area licence for the development of Red Barn Restaurants in Australia. At current conversion rates, this investment when completed will total approximately $430,000 of which $238,303 has been invested to December 31, 1970.

(c) Red Barn System (Western) Limited

Red Barn System (Canada) Limited, a wholly-owned subsidiary, is to invest $125,250 in the capital stock of Red Barn System (Western) Limited which company owns the exclusive area licence for the development of Red Barn Restaurants in Alberta and British Columbia. Of this amount $75,150 was invested to December 31, 1970.

11. CONTINGENT LIABILITIES

The company and one of its subsidiaries are contingently liable in the amount of $2,279,540 ($1,751,622 at December 31, 1969) to Frontier Acceptance Corporation Limited as guarantors of certain equipment leases financed by that subsidiary.

12. INCOME TAXES

Certain subsidiary companies have applied losses incurred in prior years against current year's income so as to reduce income taxes actually payable in the current period. These reductions in income taxes currently payable amounted to $200,800 in 1970 and $37,702 in 1969, and are included in the attached consolidated statement of earnings as extraordinary items.

Losses accumulated by certain subsidiary companies which can be carried forward so as to reduce income taxes otherwise payable in future years amount to $400,000 at December 31, 1970 ($700,000 at December 31, 1969).

13. COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

The aggregate direct remuneration paid or payable by the company to its directors and senior officers, as defined by the Ontario Business Corporations Act, amounted to $182,337 for fifteen individuals in 1970 ($158,417 for thirteen individuals in 1969).

14. FULLY DILUTED EARNINGS PER SHARE

None of the conversion and option privileges, which would require the issuance of additional common shares (the details of which are described in note 9 (d) above) if exercised at the beginning of 1970 would have had a dilutive effect on earnings per share. Accordingly, fully diluted earnings per share are not reported in these financial statements.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of Capital Diversified Industries Limited as at December 31, 1970 and the consolidated statements of earnings, retained earnings and source and use of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the companies as at December 31, 1970 and the results of their operations and the source and use of their funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

London, Canada.

March 8, 1971.

CLARKSON, GORDON & CO.
Chartered Accountants

CAPITAL DIVERSIFIED INDUSTRIES LIMITED

DIRECTORS

DONALD E. BOXER
Director, Burns Bros. and Denton Ltd.
Investment Dealers, Toronto

C. NORMAN CHAPMAN
President and General Manager,
Emco Limited, London

WILLIAM G. DINGWALL
President, Dinvest Management Limited
and associated companies, Toronto

JOHN D. HARRISON, M.B.E., Q.C.
Partner
Harrison, Elwood, Gregory, Littlejohn & Fleming
Barristers and Solicitors
London

CLARENCE W. LEONARDI, C.A.
Vice-President and Treasurer
The Glengair Group Limited
Toronto

NINIAN T. SANDERSON
President
Nintosa Investments Limited
London

KENNETH J. SHEA
London

JOHN R. SHEMILT
J. L. Goad & Co. Ltd.
Investment Dealers
Toronto

DONALD H. SWIFT
President and Chief Executive Officer
Capital Diversified Industries Limited
London

DONALD J. WILKINS
Chairman, Board of Directors
Fry & Company Limited
Investment Dealers
Toronto

RICHARD W. YANTIS
Chairman, Finance Committee
Avco Corporation
London

OFFICERS AND SENIOR MANAGEMENT

DONALD H. SWIFT
President and Chief Executive Officer

JAMES B. GIBSON
Vice-President, Operations, and Secretary

LYMAN W. OEHRING, JR., C.P.A., C.A.
Vice-President, Finance

M. THOMAS BRIGHT, C.A.
Comptroller

KENNETH G. BENTLEY, B.A. Sc., M.B.A., P. Eng.
Director of Operations

AUDITORS—Clarkson, Gordon & Co.
London, Ontario

REGISTRAR AND TRANSFER AGENT,
COMMON SHARES AND DEBENTURES—
The Royal Trust Company

LEGAL COUNSEL—Harrison, Elwood, Gregory,
Littlejohn & Fleming
London, Ontario

LISTED ON—Toronto Stock Exchange
Canadian Stock Exchange

HEAD OFFICE—195 Dufferin Avenue, P.O. Box 5376, London, Ontario

AR19

CAPITAL DIVERSIFIED INDUSTRIES LIMITED

London, Ontario

NOTICE OF A SPECIAL GENERAL MEETING OF SHAREHOLDERS

NOTICE IS HEREBY GIVEN that a special general meeting of the shareholders of CAPITAL DIVERSIFIED INDUSTRIES LIMITED (herein called the "Company") will be held at The Holiday Inn, Downtown Inn, 299 King St., Campaign Room, First Floor, London, Ontario, on Monday, September 28, 1970, at the hour of 11 o'clock in the forenoon, London, Ontario Time for the following purposes:

1. to consider, and if thought advisable, to confirm, subject to such amendments or additions as may be approved at the meeting, a special resolution passed by the directors of the Company increasing the number of directors from nine to eleven so that the Board of Directors of the Company will be composed of eleven directors with five directors to constitute a quorum at any meeting of the Board of Directors; and

2. to transact such other business as may properly be brought before the meeting.

DATED at London, Ontario this 19th day of August, 1970.

By order of the Board of Directors,
J. B. Gibson,
Secretary.

IMPORTANT

It is desirable that as many as possible be represented at the meeting. If you do not expect to attend, and would like your shares represented, please sign the enclosed proxy and return it as soon as possible in the envelope provided.

INFORMATION CIRCULAR

SOLICITATION OF PROXIES

This information circular is furnished in connection with the solicitation by the management of Capital Diversified Industries Limited (the "Company") of proxies to be used at the special general meeting of shareholders of the Company to be held at the time and place, and for the purposes set forth in the accompanying notice of meeting. The solicitation will be primarily by mail, but proxies may also be solicited personally by officers or employees of the Company at nominal cost. The cost of such solicitation will be borne by the Company.

APPOINTMENT AND REVOCATION OF PROXIES

The persons named in the enclosed form of proxy are directors of the Company. **A shareholder desiring to appoint some other person to represent him may do so** either by inserting such person's name in the blank space provided in the form of proxy and deleting the names of the said persons named in the enclosed form of proxy or by completing another proper form of proxy and, in either case, delivering the completed proxy to the Secretary of the Company at any time before the meeting. A person appointed as a proxy need not be a shareholder of the Company.

A shareholder who has given a proxy may revoke it either (a) by signing a proxy bearing a later date and delivering it to the Secretary of the Company before the time of the meeting or (b) as to any matter on which a vote shall not already have been cast pursuant to the authority conferred by it, by signing a proxy bearing a later date or written notice of revocation and, in either case, delivering it to the Secretary of the Company or to the Chairman of the meeting.

EXERCISE OF DISCRETION BY PROXIES

The persons named in the enclosed form of proxy will vote the shares in respect of which they are appointed in accordance with the direction of the shareholders appointing them. **In the absence of such direction such shares will be voted for the motion for approval of item 1 as set out in the notice of the meeting.** The enclosed form of proxy confers discretionary authority upon the persons named therein with respect to amendments or variations to matters identified in the notice of meeting, and with respect to other matters which may properly come before the meeting. At the time of printing this circular, the management of the Company knows of no such amendments, variations or other matters to come before the meeting other than the matters referred to in the notice of meeting.

VOTING SHARES AND PRINCIPAL HOLDERS THEREOF

The record date for shareholders entitled to vote at the meeting is the close of business September 22, 1970. On August 15, 1970, the Company had outstanding 3,936,190 shares without par value carrying the right to one vote per share. Neither the directors nor senior officers of the Company know of any person or company owning, directly or indirectly, equity shares carrying more than ten per cent of the voting rights attached to all equity shares of the Company.

PARTICULARS OF MATTERS TO BE ACTED UPON

The Directors of the Company at a meeting held July 17, 1970 passed a special resolution as follows:

"RESOLVED as a Special Resolution of the Company that:

1. The number of directors of the Company is hereby increased from nine to eleven so that the Board of Directors of the Company shall hereafter be composed of eleven directors.

2. Five directors shall constitute a quorum at any meeting of the Board of Directors.

3. All prior by-laws, resolutions and proceedings of the Company inconsistent herewith are hereby amended, modified and revised in order to give effect to this Special Resolution."

In order to be confirmed, this special resolution requires the affirmative vote of at least two-thirds of the votes cast at the shareholders' meeting.

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

By agreement dated January 25, 1969, the Company purchased on February 21, 1969, 22,800 shares of Middlesex Creamery Limited, 100 shares of Middlesex Investments Limited and 10,000 shares of Middlesex Reddies Limited at the aggregate purchase price of $1,750,000 payable $750,000 cash and $1,000,000 of 5½% unsecured convertible income debentures. On June 9, 1969, the debentures were exchanged for 25,000 5½% cumulative redeemable convertible sinking fund Class A preference shares of the Company having a par value of $40 each as fully paid and non-assessable shares. Mr. J. W. Adams, 1448 Corley Drive, London, Ontario, a former director of the Company, was a director of Middlesex Creamery Limited and Middlesex Reddies Limited at the time of the acquisition. Mr. Adams was also Assistant-Secretary of Burke Holdings Limited which was the beneficial owner of 2,500 shares of Middlesex Reddies Limited and 50 shares of Middlesex Investments Limited (which owned 11,400 shares of Middlesex Creamery Limited). Mrs. Kathleen L. Adams, the wife of Mr. J. W. Adams aforesaid was a director, officer and beneficial owner of all of the shares of Burke Holdings Limited which received 25% of the purchase price. At the time this transaction was discussed by the Board of Directors of the Company, Mr. Adams declared his interest, absented himself from those discussions and refrained from voting on any matters in connection therewith.

On November 21, 1969, the Company sold $5,000,000 8½% convertible subordinated debentures to Cochran, Murray & Co., Limited and Fry & Company Limited (the "Underwriters") under an underwriting agreement dated September 26, 1969. The underwriting agreement contained a condition required by the Underwriters that the directors and officers of the Company or companies with which they were associated give firm orders to purchase at least $900,000 principal amount of the convertible subordinated debentures on or before the Closing Time as defined in the underwriting agreement. The Underwriters had the right to reject in whole or in part such orders. The underwriting discount received by the Underwriters on the sale of these debentures was 2%. Certain of the directors and officers of the Company or companies with which they were associated agreed to purchase $960,000 principal amount of the debentures but were allocated only $510,000 principal amount of the debentures by the Underwriters.

INTERIM REPORT
FOR SIX MONTHS ENDED
JUNE 30TH, 1970

CAPITAL
DIVERSIFIED
INDUSTRIES LIMITED

REPORT TO SHAREHOLDERS

In the following report of your Company's earnings, sales and operations for the first six months of 1970 we have provided explanations as to the variances in sales, profits and expenses as compared to the same periods in 1969.

EARNINGS

CAPITAL DIVERSIFIED INDUSTRIES LIMITED

UNAUDITED CONSOLIDATED SUMMARY OF NET EARNINGS

	Six months ended June 30	
	1970	1969
Sales	$ 8,685,685	$ 5,691,618
Other revenues	878,371	977,399
	$ 9,564,056	$ 6,669,017
Earnings before income taxes and extraordinary items	$ 154,826	$ 575,985
Provision for income taxes	99,160	325,000
Earnings before extraordinary items	55,666	250,985
Extraordinary items:		
Loss on disposal of fixed assets	(903)	—
Reduction of income taxes as a result of application of prior years' losses	27,660	8,000
Loss on sale of marketable securities	—	(2,137)
Capital gain on expropriation	—	5,000
Capital gain on note discounted	—	22,500
Net earnings	$ 82,423	$ 284,348
Net earnings per common share, after preference dividends	$ .01	$ .07

Net earnings for the six months ended June 30, 1970 were $82,423 as compared with an adjusted $284,348 for the same period in 1969. After dividends on Capital's preference shares, which were $45,500 in 1970 and $5,485 in 1969, earnings per common share were $.01 and $.07, respectively.

Earnings were substantially less than in 1969 for the following reasons: housing sales were down by 68%; costs of carrying the new office building which is only 50% rented; lack of funds at interest rates that would allow profitable Red Barn expansion resulting in fewer franchise fees; and the non-recurring costs of closing the Essex Cabinet Manufacturing operation in Ottawa. However, second quarter earnings were nearly three times that of the first quarter and we anticipate this trend to continue.

FINANCIAL

As previously reported we have been seeking satisfactory long term financing for the Red Barn properties that now total over $5,500,000. We are currently negotiating such financing and are hopeful of reaching a satisfactory conclusion during the next ninety days.

These negotiations when finalized will strengthen our working capital position and allow the Company to retire all short term debt and continue with its planned expansion program. In the meantime, the Company's internal cash flow is sufficient to meet all current and long term requirements plus a moderate expansion program in Pricegard, Red Barn and Capital Foods divisions.

OPERATIONS

Frontier Acceptance Division

Tight money and high interest rates particularly affect this type of operation. While there has been a recent downtrend in interest rates they remain historically high. As a result this Division continues to reduce receivables in certain areas so that these funds can be utilized on a more profitable basis in new fields. Expenses have been closely reviewed and economies affected wherever possible and the Division's profits for the first six months of 1970 are comparable with the same period of 1969.

Construction and Development Divisions

Because the activities of these two Divisions have become a combined operation, we felt we should report it to you as one showing the various activities.

The single family dwelling market remains very depressed due to continued high interest rates, unemployment and other uncertainties that are with us in our daily economic climate at this time. Sales for the first six months of 1970 were $248,100 versus $798,700 in 1969. This 68% decline in sales, of course, has had a substantial effect on the overall profitability of Capital. It is heartening to note, however, that sales for July and August will almost equal those of the first six months. While this is a substantial improvement we do not foresee the housing activity increasing to the point where it will overcome the loss of sales in the first six months. While management is projecting a profitable year we feel it will be far below the results achieved in 1969. We continue to monitor market conditions daily and are maintaining inventories in line with sales.

As previously reported, our OHC contract in Windsor for 220 units, is well under way. We are pleased to report that this project is proceeding ahead of schedule and we are now forecasting a 75% completion by the year end.

The rental of our new office building in London has been much slower than anticipated with approximately 50% now rented. It is Capital's intention to move its head office to this location in October, 1970 along with the Red Barn and Frontier head office operations. All of the above will be located on the sixth floor at 195 Dufferin Avenue.

As previously reported we have been constantly striving to sell all parcels of land that are either non-revenue producing or on which we cannot foresee development in the near future. Actual sales in this area have been very slow, again due primarily to present economic conditions.

We are confident that the combined activities of this Division will contribute to the overall profitability of Capital.

Red Barn Division

Red Barn is continuing its expansion program in Canada and Australia. The pace of new openings in Canada has slowed somewhat compared to 1969 due to the high cost of financing.

New units were opened in Whitby on June 9th, Sault Ste. Marie on August 18th, and further openings will take place in Sudbury and North Bay, Ontario, during the balance of the year.

While overall sales for Red Barn units in Canada are below projections most areas continue to show satisfactory sales performance. An aggressive advertising and promotional campaign has been developed in conjunction with Red Barn U.S. and its advertising agency, J. Walter Thompson, which will be introduced in all markets in September.

A realignment of executive responsibilities and other changes have resulted in a considerable reduction of overhead in this Division and it continues to be a major contributor to Capital's overall profitability.

Recent newspaper reports from Toronto indicate successful litigation of a fast food franchisee against his franchisor for the recovery of rebates paid by suppliers to the franchisor relating to the franchisee's purchases. Red Barn does not follow the practice of accepting rebates from suppliers with respect to franchisee purchases and does not plan to do so. Our policy has always been and will continue to be that of assisting our franchisees to purchase their supplies at the lowest possible prices consistent with quality.

Area Franchises

Red Barn System (Western) Limited is constructing its first unit in Vancouver and the opening is scheduled for mid-September. This company owns the franchise for the Provinces of British Columbia and Alberta and expects to open a total of thirty units during the next five years.

Six Red Barn family restaurants are now in operation in Australia and sales in these units are most encouraging. Another unit is under construction with plans for three more by year end. A visit to Red Barn is rapidly becoming a family affair in Australia and the name is well established and already recognized as a leader in the fast food industry in that country.

Pricegard Division

The number of outlets in the chain as of June 30th, 1970 numbered 29 as compared to 24 on June 30th, 1969. In comparing stores in operation for one full year or more, sales for the first six months of 1970 were up 15%. Management has been reducing inventory and overhead to make the Division's operations more efficient, thereby increasing profitability.

While our expansion program has slowed considerably, we are currently seeking new locations plus acquisitions so the Division can eventually attain its goal of servicing fifty locations from its present warehouse facilities in London, Ontario. Traditionally sales and profits are greater during the last six months of the year, and the same pattern is expected to prevail in 1970.

Capital Foods Division

Reddies pre-portioned butter and margarine sales increased 18% over the comparable six month period in 1969. Print butter sales have remained steady. While there has been a general decrease in egg prices due to over-production, sales have increased in our Strathroy operation.

Construction of a 12,000 square foot addition to our Strathroy plant is scheduled to begin within the next thirty days and will be completed and in operation by year end. While this will not contribute in any meaningful way to our 1970 profits, we believe it will contribute substantially in 1971.

Our joint venture with Northern Dairies of England is under way. The plant is in production and Reddies are now being test marketed in the United Kingdom.

The total Division has operated more efficiently than projected and profits are substantially ahead of budget.

OUTLOOK

With the exception of land and housing sales, all other Divisional activities look encouraging. Monetary restraints appear to be easing, hopefully allowing us to accelerate our planned expansion programs. The past six months, while having produced less than satisfactory profits, have enabled management to consolidate our present position and prepare for future growth. All Divisions are operating on a profitable basis and with certain seasonal sales increases ahead of us, we look to the remainder of the year with an optimistic view.

SPECIAL NOTICE

Enclosed with this report you will find a notice calling a Special General Meeting of Shareholders to approve a resolution passed by your Board of Directors. This resolution authorizes an increase in your Board of from nine to eleven members and increases the number of Directors constituting a quorum from four to five.

We urge you to execute and mail the enclosed form of proxy should you not be able to attend the meeting in person.

The Directors of your Company feel an increase in the number of Board members would add greater shareholder representation, benefit the Company through additional expertise in certain areas, and improve our corporate communications with various segments of the economy. I am sure you will agree with this change in the Company's corporate policy.

Yours very truly,

D. H. Swift

D. H. Swift
President

August 19, 1970

CAPITAL DIVERSIFIED INDUSTRIES LIMITED

Unaudited Consolidated Statement of Source and Use of Funds

	Six months ended June 30 1970	1969
Source of Funds:		
Net earnings for the period	$ 82,423	$ 284,348
Add charges not requiring cash outlay:		
Depreciation and amortization	151,295	96,140
Amortization of financing expenses	13,352	5,832
Increase in deferred income taxes	900	18,723
	247,970	405,043
Deduct:		
Net earnings of unconsolidated finance subsidiary less dividends received therefrom	39,644	42,548
Decrease in deferred income from sale of area licences	12,000	—
	51,644	42,548
Funds provided from operations	196,326	362,495
Proceeds from issue of capital stock	—	1,611,900
Increase in mortgages and notes payable	49,277	183,966
Decrease in mortgages and notes receivable	18,154	202,792
	263,757	2,361,153
Decrease in working capital	460,275	1,672,449
	$ 724,032	$ 4,033,602
Use of Funds:		
Acquisition of fixed assets, net	$ 335,986	$ 1,830,145
Increase in investments in commercial real estate and other companies	148,464	26,835
Retirement of secured income debentures	—	794,911
Increase in excess cost of subsidiaries over equity acquired therein and other intangible assets, net	74,082	1,376,226
Redemption of Class "B" preference shares	120,000	—
Payment of preference share dividends	45,500	5,485
	$ 724,032	$ 4,033,602